

**COMMONWEALTH OF MASSACHUSETTS  
BEFORE THE  
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

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REQUEST FOR COMMENTS ON THE	)	D.T.E. 04-115
PROCUREMENT OF DEFAULT SERVICE	)	
POWER SUPPLY FOR RESIDENTIAL AND	)	
SMALL COMMERCIAL AND INDUSTRIAL	)	January 7, 2005
CUSTOMERS.	)	

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**COMMENTS OF  
SELECT ENERGY, INC.**

Select Energy, Inc. ("Select") appreciates this opportunity to participate in the Department of Telecommunications and Energy ("DTE" or "Department") inquiry into the procurement of Default Service Power Supply for residential and small commercial and industrial ("C&I") customers.

Select is an active participant in the competitive wholesale and retail electricity markets throughout the northeastern United States. In particular, Select has been a provider of Standard Offer and Default Services in Massachusetts and similar requirements services throughout the northeast. Select is also a licensed retail competitive energy supplier in Massachusetts and currently serves retail customers in the Commonwealth.

The following responses track the format used in the Department's Request for Comments issued December 6, 2004, in the above-captioned proceeding:

1. *Would smaller customers be better served if power supply for default service is procured using a portfolio of more than two solicitations? Please discuss the advantages and disadvantages of increasing the number of solicitations used to procure default service supply.*

Advantages:

The market price of wholesale power is volatile due to the influence of many factors, including projections of fuel cost, weather, peak and off-peak load levels, changes in state and federal regulations, and the availability and proximity of generation to serve load. More frequent solicitations would send more accurate price signals to customers of the then-current market price of power.<sup>1</sup>

In addition, more solicitations could lead to shorter duration supply commitments, which can reduce price uncertainty risk, and volume (egress/ingress) risk to suppliers. This could tend to produce lower prices to customers.

Disadvantages:

The volatility associated with more frequent solicitations can be a concern to customers – particularly smaller customers. On the other hand, larger more sophisticated customers are more likely to be able to handle such volatility through market mechanisms, such as procuring their power supply through competitive power suppliers.

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<sup>1</sup> A certain degree of price signal could be provided through longer-term solicitations of power supply with shaped prices (e.g., a utility could solicit a longer-term power supply based on a schedule of power prices that could vary over the term, for example, monthly). However, as discussed herein, longer term supplies tend to be more expensive as a result of the risk margins built in to their prices.

The effort required of utilities to develop and issue Requests for Proposals ("RFPs") and to evaluate responses in order to select winning bidders, and the requirements on suppliers of bidding in RFPs is time and resource intensive. Too many solicitations become administratively burdensome to suppliers and utilities alike. This could result in increased prices due to increased administrative costs, or as a result of reduced supplier participation due to constraints on suppliers' resources available to respond to a multitude of RFPs.

Select Recommendation:

Select believes that the current procurement method provides a reasonable balance for smaller customers between the decreased volatility associated with longer-term contracts and lower prices associated with shorter-term solicitations.

2. *Would smaller customers be better served if power supply for default service was procured for a term longer than twelve months? Please discuss the advantages and disadvantages of using supply terms greater than twelve months. In particular, please discuss:*

- a. *whether longer contract terms are likely to produce lower prices,*

Longer term contracts expose wholesale suppliers to increased risks, including changing fuel prices, loads varying from projections, regulatory uncertainty, and increased egress or ingress of customers. Therefore, longer term solicitations tend to produce higher priced contracts than shorter term RFPs because of price and volume risks that have to be factored into suppliers' bids.

In addition, longer term contracts tend to lock prices in for a longer period of time. Depending on whether a particular RFP occurs at a high or low in the market cycle, a longer term contract can lock customers into a higher or lower price.

- b. *how such an approach would affect price certainty and market efficiency, and*

Longer term contracts tend to increase price certainty because they tend to lock prices for a longer period, as compared to shorter duration contracts, which increase price volatility. Depending on whether a particular solicitation occurs at a high or low point in the market cycle, a longer term contract could lock in a higher or lower price. Accordingly, longer term contracts tend to look good to consumers in a rising market and look bad in a falling market.

In terms of market efficiency, the liquidity of the current wholesale market is inversely related to the term of service. In other words, the market loses liquidity as the duration of the commitment increases. In New England, the market becomes relatively illiquid beyond two years. Thus, there are likely to be fewer participants for a longer term contract, which is likely to lead to higher prices.

- c. *how such an approach could be tailored to accommodate customer migration to competitive supply.*

The risks and resulting costs of load fluctuating from projected amounts increase with the level of customer ingress and egress. Moreover, there is an inherent relationship between the length of

contract and the risks associated with the wholesale power contract, i.e., the longer the contract term, the greater potential of customer/load ingress or egress risk. Consequently, contract term has a corresponding impact on the cost of Default Service. Select believes that the current Default Service procurement method, based on a twelve month contract term, strikes a reasonable balance between supporting unimpeded retail competition and maintaining reasonable mitigation risks to wholesale power suppliers. Accordingly, Select believes that the Department should retain the current Default Service procurement methodology based on twelve month contracts.

3. *Would smaller customers be better served if power supply for default service was procured on a statewide basis? Please discuss the advantages and disadvantages of using a statewide approach to default service procurement.*

Advantages:

Theoretically, a state-wide solicitation would be easier to administer than the current system of individual utility RFPs.

Disadvantages:

Currently, each utility has its systems in place to solicit power supply on behalf of its customers. If Massachusetts were to switch to a state-wide system, whole new systems would have to be put in place to solicit power supply. In addition, even a state-wide solicitation would have to be tailored to the individual utilities to accommodate differences such as SMD zones and individual company infrastructure. Any such change would create costs for all stakeholders.

Moreover, if the entire power supply for Massachusetts were bid at one time, it would put an undue strain on the market. Trying to clear such a large volume would tend to decrease market liquidity and drive prices higher. This approach could be more expensive for residential and small C&I customers.

Select Recommendation:

Select recommends that the current utility-specific procurement process be maintained.

4. *Would smaller customers be better served if power supply for default service was procured using an auction process (e.g., descending clock) rather than through requests for proposals? Please discuss the advantages and disadvantages of using an auction process to procure default service. In particular, please discuss whether using an auction is likely to produce lower default service prices.*

Advantages:

In Select's experience, a descending clock auction is an effective approach toward producing efficient prices.

Disadvantages:

An auction would likely have to be conducted on a state-wide basis. As noted above, the increased size of such a state-wide solicitation would tend to increase prices. In addition, as noted above, entirely new systems would have to be put in place to replace the existing utility systems. Establishing such new systems, as well as, administration and oversight can be a considerable expense.

Select Recommendation:

If Massachusetts were starting from scratch, a state-wide auction might have advantages. However, where the current system works well, Select recommends that the current approach be retained for the foreseeable future.

5. *Although the term "default service" is statutory, G.L. c. 164 § 1, it has confused some customers because of its unintended suggestion of nonfeasance in performing a legal or contractual obligation. Is there some better or more descriptive term that ought to be used by the distribution companies on and after March 2005?*

Select believes the term "Basic Service" would be preferable to the term "Default Service."

Select requests that the following persons be included on the service list in this proceeding:

Frederic Lee Klein  
Assistant General Counsel  
Select Energy, Inc.  
107 Selden Street  
Berlin, CT 06037  
860-665-2926  
860-665-2330 Fax  
kleinfl@nu.com

and

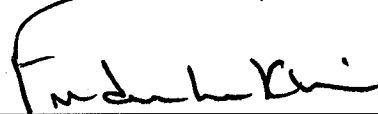
Marc Hanks  
Select Energy, Inc.  
107 Selden Street  
Berlin, CT 06037  
860-665-2721  
860-665-2180 Fax  
hanksma@selectenergy.com

In conclusion, Select endorses retention of the current Massachusetts model for procuring power supply for residential and small C&I customers. The current one year contracts present reasonable risks (e.g., fuel price uncertainty, ingress/egress risk, commodity liquidity in the market) to potential suppliers and therefore hedging costs and premiums added to commodity prices are reduced, resulting in relatively lower priced power supply to consumers. The overlapping terms (e.g., twelve months beginning January and twelve months beginning July) tend to also decrease the risk that all of the power will be procured during a market high, and will also help to stabilize consumer prices by averaging two prices from two different periods in the market instead of procuring all of the utility's needs at one time.

Select appreciates this opportunity to submit its comments herein and looks forward to actively participating in any further dialogue on this important issue.

Respectfully submitted,

SELECT ENERGY, INC.



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Frederic Lee Klein  
Assistant General Counsel  
Select Energy, Inc.  
107 Selden Street  
Berlin, CT 06037  
860-665-2926  
860-665-2330 Fax  
kleinfl@nu.com